$50.00 ANNUALLY
40 Letters Per Year

Dow Theory Letters

"The Market as Interpreted under the Dow Theory"

RICHARD RUSSELL
125 East 93rd Street
New York City 28

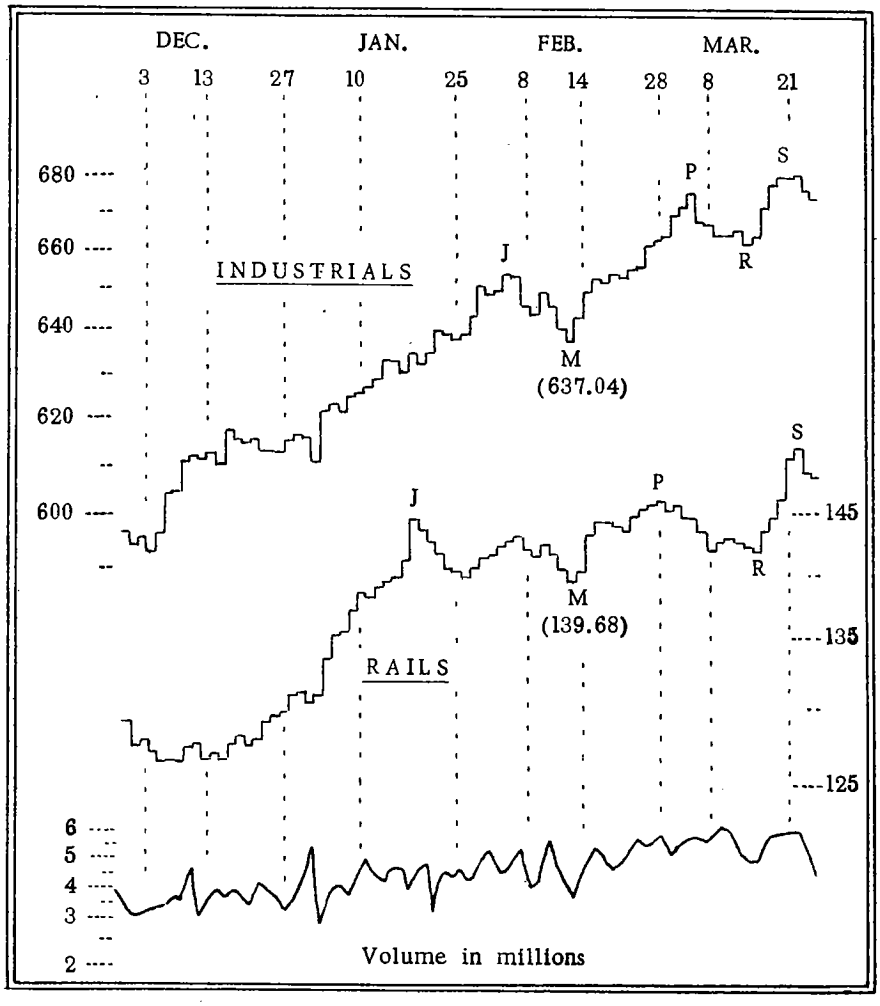
Registered with the Securities and Exchange Commission

All Rights Reserved

PRICE MOVEMENT AND MARKET TACTICS Having formed a series of ascending bottoms and tops (J-M-P-R), the Rails on March 20 rose above their 1961 peak at P (146.01). On March 22 Rails again rallied sharply. By the close of that day Rails had climbed 3.61 points to a new recovery high at S (150.81). Thus the long awaited penetration of the March, 1960 Rail peak was accomplished, and the Rails have now confirmed the previous penetration of Industrials. With the joint bettering of the 1960 secondary highs, the evidence strongly points to the primary trend's having turned bullish.

On March 22 the Industrial Average rose to a new recovery high at S (679.38), just 6.09 points below their all-time high of 685.47. The next day (Thursday, March 23) saw both Averages retreat as volume shrank to 5.17 million shares. On March 24 the two indicators declined again, and here volume dropped to 4.39 million shares, the lowest volume since February 13. If there is any amount of overhanging stock to be liquidated, the volume indications (so far) give no hint of it.

The secondary trend is bullish and will remain bullish as long as one or both Averages hold above the preceding M points (see chart). Had Rails not confirmed, any decline from this area would have been viewed as a possible resumption of the primary bear trend. With the Rail confirmation, any substantial decline will now be viewed as an opportunity for buying.



First minor checkpoints on the downside are at R (Industrials 661.08, Rails 142.09). If, on an approach to the R points, one or both Averages can hold above those points as volume contracts, purchases will be in order. If the R points are violated, the M points will hold the same significance.

The ideal "buy-spot" is identified as follows: (1) both Averages decline, (2) a rally ensues, (3) a second decline occurs during which one or both Averages hold above

the preceding decline lows as volume diminishes. This second decline on contracting volume represents the ideal buy-spot. If the next rally takes both Averages above the preceding rally peaks, the correctness of the buy-spot will have been validated.

With Industrials now in the vicinity of the 685.47 high, it would be normal to witness a period of erratic or nervous price fluctuations. Often a "line" of a few weeks' duration is formed by the Averages under primary points preparatory to a penetration. If a "line" is now formed, stock may be purchased within the line area.

SUMMARY The hurdling of the secondary highs came without a prior primary reversal pattern (see Letter 133). Moreover, at the September-October lows there were few if any of the indications which normally are associated with bear-market bottoms (low volume, depressed psychology, high yields, great values). Taking all this into consideration, it is, nevertheless, this writer's opinion that the Rail confirmation together with technical factors (odd-lots, breadth, volume) strongly favor the view that the primary trend turned up on September 29, 1960 (the day on which the last confirmed lows of the bear market were recorded).

Everywhere people are asking: "How long can the advance last?" I do not know, and Hamilton was specific in stating that neither he, Dow's Theory, nor any other theory could successfully predict the extent or duration of a primary swing. A bull market started in March, 1938, and advanced the Industrial Average better than 50% before it was completed in November of that year. Yet Rhea classified the movement as a completed bull market. Another bull market began in May, 1947, and ended in June, 1948. In both instances the phases were indistinct or totally lacking as seems to be the case today. Lack of easily recognizable phases is almost a characteristic of short bull and bear markets.

Another point worth noting was expressed by Hamilton in an editorial in 1923: "Major bull and bear markets vary in length, but when they are violent they are usually relatively short..." Rhea amplified this idea in reference to individual bull swings: "Fast rallies and rapidly expanding volume cannot continue forever. Great upward velocity tends to inflame speculative fever, and ultimately breeds a reaction, the severity of which is always somewhat in proportion to the type of advance." Again he wrote: "It is sometimes useful to remember that a violent uprush in a short period is apt to breed a decline of nearer 2/3 than 1/3, whereas a slow, steady rally, spread over a number of months, is more apt to father a reaction of the 1/3 variety."

I have often stated in these Letters that I neither make nor influence the market. I try to follow the price movement to the best of my ability, and if the market "misbehaves" or does not provide easily recognizable reversal signals or embarks on a sustained swing with little or no correction, there is nothing that I or anybody else can do about it. Correspondence has arrived at this office in large quantities over the last few weeks, and I have tried to answer as many letters as possible. In general, letters received here can be divided into two categories: (1) those who owned or now own stocks and are happy about the Rail confirmation, and (2) those who do not own stocks or those who believe that the Rail signal was a false one and are not willing to act upon it.

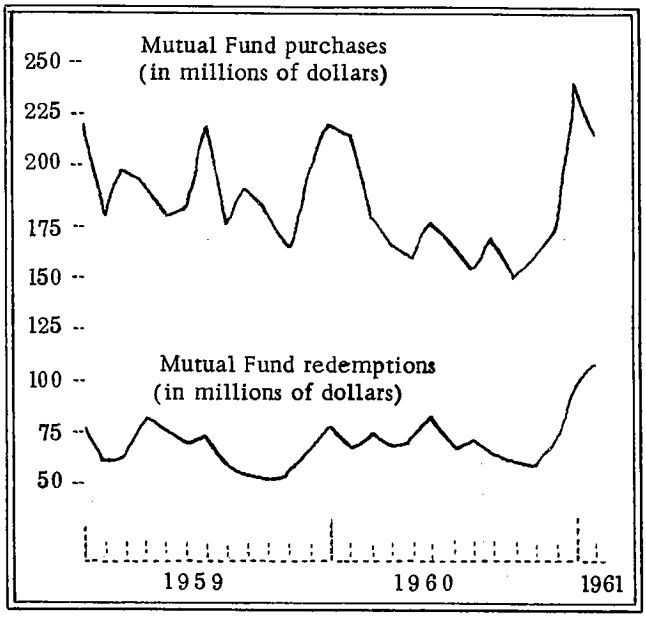
There have been a number of "false signals" given by the Averages over the last 65 years, and many analysts pride themselves on being able to "rattle off" five or six instances when the Averages "went haywire". From my own experience and from my studies of the charted history of the price movement going back to 1896, I would guess that there have been five profitable indications given by the Averages for every one that has proved deceptive.

From the standpoint of my own account, I covered shorts back in October when the Rail Average refused by 14¢ to confirm the new low made by Industrials (see Letter 121). Letter 126 (December 8, 1960) stated: "If the two Averages can hurdle their preceding highs (Industrials at 621.08, Rails 130.13) we will have the most impressive pattern of the year. In case of the latter, all shorts should be closed out". It goes without saying that few readers (myself included) envisioned the explosive market performance which was to follow that confirmation.

I have learned through painful experience not to argue with the Averages. I may not always follow a move, but that is a far cry from speculating against it. In almost every case, where my instincts and common sense have said one thing and the market has said something else, it was the market that was right, and it was my pride and my pocketbook that were the sufferers.

The Rails gave their half of the bull signal on February 27. Nobody can know for certain what that signal will mean -- whether the market will continue to rise for another 25, 50 or 150 points, or whether there will be a reaction now or a month from now. I can think of a dozen reasons to justify the view that the market is "unsound", "too high" or even dangerous. But the Averages are pointing up, and in this business (when you are able to) you must "call them as you see them".

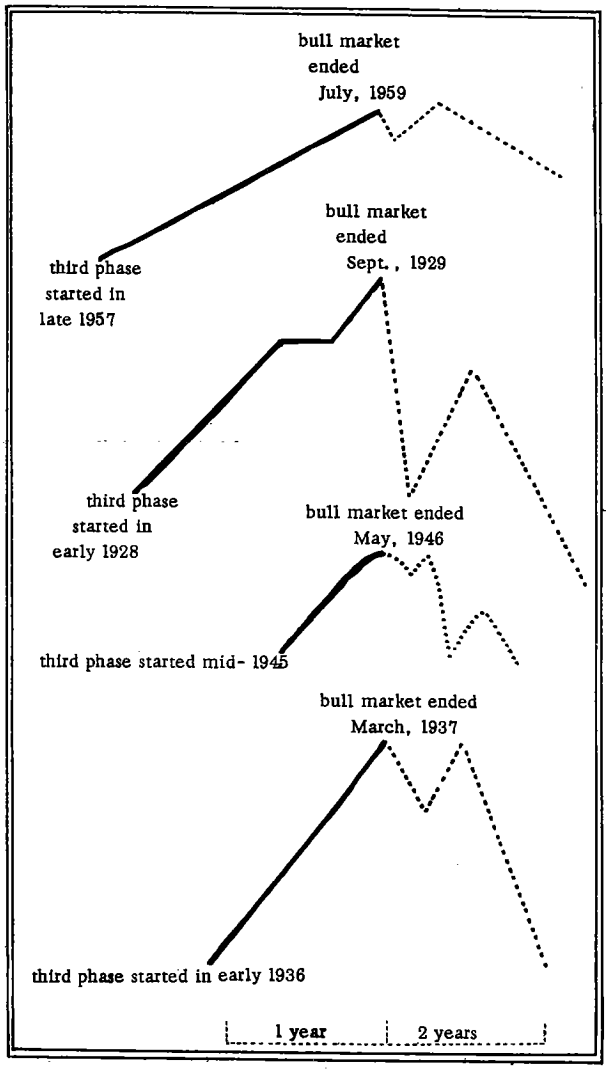
PSYCHOLOGY Letter 137 commented on the general psychology of the public as represented by the odd-lot transactions. Attention was directed to the fact that since December, 1960, the odd-lot public has been skeptical of the rising market. Now that Rails have confirmed the move the attitude of the public is even more significant (because the market has said that the trend is up and the public still does not believe it). Further proof of public skepticism is shown by the latest (February) customers' free credit balance figures. Those figures show that the public has cash at the brokerage offices to the record-breaking tune of 1.392 billion dollars.



A third most curious phenomenon has now appeared. I have included a chart which shows monthly mutual fund purchases and redemptions. Over the last two months redemptions have soared to the highest figures on record. In fact, in February redemptions rose to 50% of sales for the first time. In other words, one mutual fund share was sold for every two bought during February.

Taken at face value, the three indicators suggest that public skepticism stubbornly continues (which fact must be taken bullishly). It is perhaps ironical to note that amid this type of caution there also exists a sort of schizophrenic condition which allows for almost absurd speculation in many new issues, unlisted stocks and over-the-counter equities.

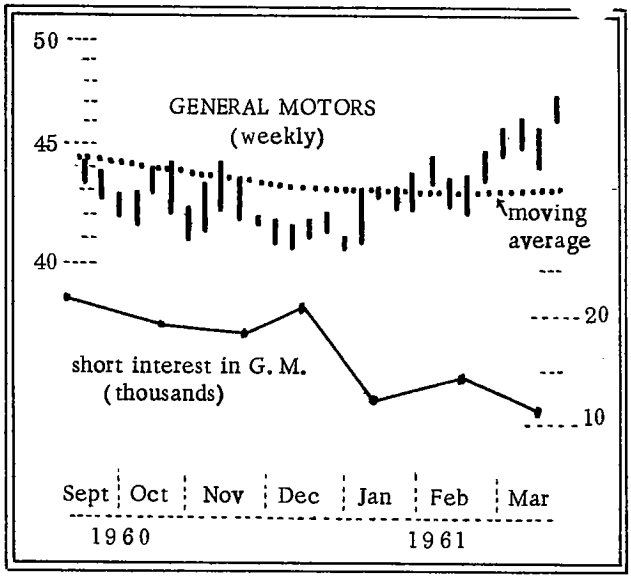
COMPARISONS A number of subscribers have asked whether the 1959-60 episode could not be taken as a particularly severe or complex secondary reaction in a continuing (bull market) third phase. In my opinion, the downturn which began in July, 1959, was a true bear market, although admittedly a mild one. During 1959-60, low priced stock indexes lost better than one-third of their values, many good quality stocks were subject to severe percentage losses and the total market decline continued over a period of fourteen months.


bull market ended July, 1959
third phase started in late 1957
bull market ended Sept., 1929
third phase started in early 1928
bull market ended May, 1946
third phase started mid- 1945
bull market ended March, 1937
third phase started in early 1936
1 year
2 years

There is another aspect of the 1959-60 period worth noting. I have included a chart which shows the third phase advance (heavy black line) during each of the last four major bull markets. Note that without exception, once major bull markets have entered their third or "boom" phase they have progressed to conclusion (or final "topping-out") without an important or prolonged interruption. The light dotted line shows the path of the subsequent bear market which followed each major bull market (for want of space only part of the 1929-32 bear market is shown).

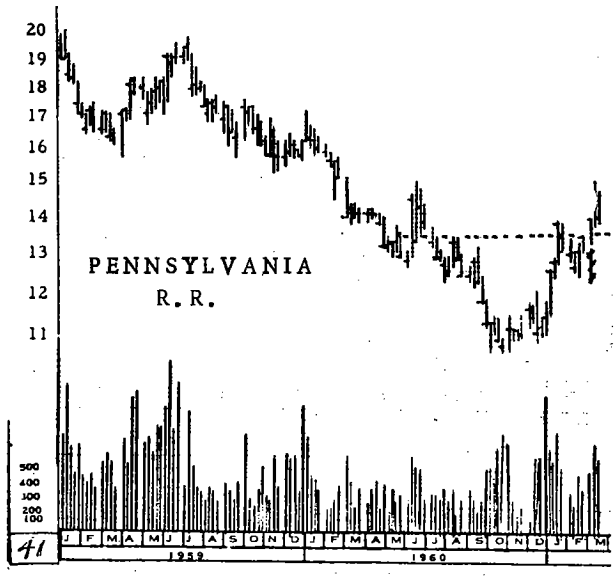
Barron's Low-Priced Stock Index now stands at 203, having recovered only 46% of its 1959-60 losses (the Index dropped from a 1959 high of 250 to a 1960 low of 162). If the current advance was simply a continuation of the third phase of the 1949-59 bull market we would expect the low-priced Indexes to have lead the advance, not lag, as has been the case (Standard & Poor's L-P Index is also well below its 1959 high).

STOCKS The chart shows the stock of America's largest auto manufacturer (G. M.) bettering its 30-week moving average and going into a pronounced upward trend. Of particular interest is the monthly short interest in G. M. Shorts are slowly moving out of the stock as it rises, and to the extent that this is taking place, it represents technical deterioration. A trend of declining shorts is quite typical of the majority of Dow stocks at this time. Exceptions are G. E. and Westinghouse, where actual bearish news has succeeded in gathering substantial short totals over the past few months.



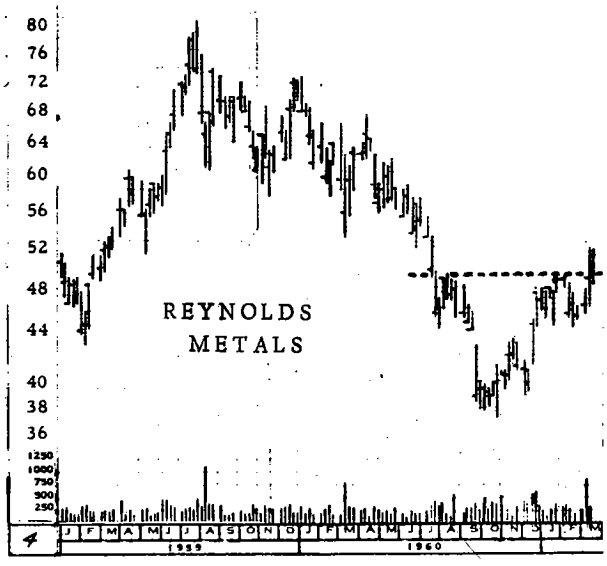
Pennsylvania R. R. having lost half its value during 1959-60, has now formed a large inverse "head-and-shoulders" pattern. The stock would appear to be a buy at the market. New York Central, Southern Pacific and Northern Pacific also are in bullish formations. During major advances the Rail Average has been known to make up for lost time. Final percentage swings in the Rail Average frequently far surpass those of Industrials.

Patterns of accumulation and distribution remain much the same, regardless of the stock or the group. The chart shows the bear market collapse of Reynolds Metals. Here, as in Penn. R. R., an inverse head-and-shoulders has formed and broken to the upside. The stock is in a position for buying, and a technical plus is provided by the whopping 130,000 short position in RLM.



QUESTION "Is it possible, by charting the action of the thirty individual D-J Industrial stocks and the twenty D-J Rail stocks, to draw valid conclusions regarding the next direction which the Averages will take?" (B. H. T. Akron, Ohio)

ANSWER In theory this would seem to be a valid system for "getting the jump" on the Averages. I have followed the individual charts of the Dow stocks for many years, however, and can report little or no success with the above procedure. Moreover, I have found that trend inferences based on the chart patterns of the Dow stocks can be exasperatingly deceptive. Readers are cautioned to use the Averages alone for determining the trend. Once the trend is determined, individual stock charts can be used for trading purposes.



(Written Monday, March 27 - 2 P. M.)

Charts of Pennsylvania R. R. and Reynolds Metals courtesy of Traders Research, Box 6185, Lambert Airport, Missouri